# ARIZONA CORPORATION COMMISSION
# UTILITIES DIVISION

ANNUAL REPORT MAILING LABEL – MAKE CHANGES AS NECESSARY

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E-04204A
UNS Electric, Inc.
Attn: David Couture
P.O. Box 711, MS UE201
Tucson, AZ 85702

RECEIVED
APR 15 2008
AZ CORPORATION COMMISSION
DIRECTOR OF UTILITIES

# ANNUAL REPORT

## FOR YEAR ENDING

| | | |
|---|---|---|
| 12 | 31 | 2007 |

FOR COMMISSION USE

| | |
|---|---|
| ANN 01 | 07 |

PROCESSED BY:
4-16-08

SCANNED

## COMPANY INFORMATION

**Company Name (Business Name)** UNS Electric, Inc.

Mailing Address P.O. Box 711, Mail Stop UE201
(Street)

| Tucson | Arizona | 85702 |
|---|---|---|
| (City) | (State) | (Zip) |

| 520-884-3752 | 520-884-3601 | N/A |
|---|---|---|
| Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Pager/Cell No. (Include Area Code) |

Email Address dcouture@tep.com

Local Office Mailing Address PO Box 711, Mail Stop UE201
(Street)

| Tucson | Arizona | 85702 |
|---|---|---|
| (City) | (State) | (Zip) |

| 520-884-3752 | 520-884-3601 | N/A |
|---|---|---|
| Local Office Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Pager/Cell No. (Include Area Code) |

Email Address dcouture@tep.com

## MANAGEMENT INFORMATION

**Management Contact:** David Couture (Name) — Director, Regulatory Services (Title)

| One South Church Avenue, Mail Stop UE-201 | Tucson | Arizona | 85702 |
|---|---|---|---|
| (Street) | (City) | (State) | (Zip) |

| 520-884-3752 | 520-884-3601 | N/A |
|---|---|---|
| Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Pager/Cell No. (Include Area Code) |

Email Address dcouture@tep.com

**On Site Managers:**

| | |
|---|---|
| Aldo "Bill" DeJulio, Jr., General Manager (Name) | David Thomas, T&D Operations General Manager (Name) |
| 2498 Airway Ave. (Street) Kingman, (City) AZ (State) 86402 (Zip) | 4350 E. Irvington Rd/PO Box 711 (Street) Tucson, (City) AZ (State) 85714 (Zip) |
| 928-681-8902 Telephone No. (Include Area Code) | 520-745-3429 Telephone No. (Include Area Code) |
| 928-681-8915 Fax No. (Include Area Code) | 520-571-4101 Fax No. (Include Area Code) |
| 928-716-3212 Pager/Cell No. (Include Area Code) | 520-403-0813 Pager/Cell No. (Include Area Code) |
| Email Address bdejulio@uesaz.com | dthomas@tep.com |

☒ Please mark this box if the above address(es) have changed or are updated since the last filing.

**Statutory Agent:** Diana K. Durako
(Name)

| | | | |
|---|---|---|---|
| One South Church Avenue, UE201 | Tucson | Arizona | 85701 |
| (Street) | (City) | (State) | (Zip) |

| | | |
|---|---|---|
| 520-571-4000 ext. 3652 | 520-884-3612 | N/A |
| Telephone No. (Include Area Code) | Fax No. (Include Area Code | Pager/Cell No. (Include Area Code) |

**Attorney:** Raymond S. Heyman
(Name)

| | | | |
|---|---|---|---|
| P.O. Box 711 | Tucson | Arizona | 85702 |
| (Street) | (City) | (State) | (Zip) |

| | | |
|---|---|---|
| 520-571-4000 | 520-884-3612 | N/A |
| Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Pager/Cell No. (Include Area Code) |

☒ **Please mark this box if the above address(es) have changed or are updated since the last filing.**

## OWNERSHIP INFORMATION

Check the following box that applies to your company:

- ☐ **Sole Proprietor (S)**
- ☒ **C Corporation (C) (Other than Association/Co-op)**
- ☐ **Partnership (P)**
- ☐ **Subchapter S Corporation (Z)**
- ☐ **Bankruptcy (B)**
- ☐ **Association/Co-op (A)**
- ☐ **Receivership (R)**
- ☐ **Limited Liability Company**
- ☐ **Other (Describe)**__________

## COUNTIES SERVED

Check the box below for the county/ies in which you are certificated to provide service:

| | | |
|---|---|---|
| ☐ **APACHE** | ☐ **COCHISE** | ☐ **COCONINO** |
| ☐ **GILA** | ☐ **GRAHAM** | ☐ **GREENLEE** |
| ☐ **LA PAZ** | ☐ **MARICOPA** | ☒ **MOHAVE** |
| ☐ **NAVAJO** | ☐ **PIMA** | ☐ **PINAL** |
| ☒ **SANTA CRUZ** | ☐ **YAVAPAI** | ☐ **YUMA** |
| ☐ **STATEWIDE** | | |

## SERVICES AUTHORIZED TO PROVIDE

Check the following box/es for the services that you are authorized to provide:

☒ **Electric**

- ☒ Investor Owned Electric
- ☐ Rural Electric Cooperative
- ☐ Utility Distribution Company
- ☐ Electric Service Provider
  - ☐ Transmission Service Provider
  - ☐ Meter Service Provider
  - ☐ Meter Reading Service Provider
  - ☐ Billing and Collection
  - ☐ Ancillary Services
  - ☐ Generation Provider
  - ☐ Aggregator/Broker

☐ **Telecommunications**

- ☐ Incumbent Local Exchange Carrier
- ☐ Interexchange Carrier
- ☐ Competitive Local Exchange Carrier
- ☐ Reseller
- ☐ Alternative Operator Service Provider

☐ **Gas**

- ☐ Natural Gas
- ☐ Propane

☐ **Other** (Specify)________________________________________

________________________________________________________

## STATISTICAL INFORMATION

### TELECOMMUNICATION UTILITIES ONLY

| | |
|---|---|
| Total residence local exchange access lines | __________ |
| Total business local exchange access lines | __________ |
| Total revenue from Arizona operations | $__________ |
| Total income from Arizona operations | $__________ |
| Value of assets used to serve Arizona customers | $__________ |
| Accumulated depreciation associated with those assets | $__________ |

## STATISTICAL INFORMATION (CONT'D)

### ELECTRIC UTILITY PROVIDERS ONLY

| | | |
|---|---|---|
| Total number of customers (at 12/31/2007) | 89,992 | |
| Residential | 79,433 | |
| Commercial | 10,291 | |
| Industrial | 13 | |
| Public street and highway lighting | 254 | |
| Irrigation | | |
| Resale | 1 | |
| Total kilowatt-hours sold | 1,684,380,000 | kWh |
| Residential | 854,119,000 | |
| Commercial | 626,738,000 | |
| Industrial | 198,728,000 | |
| Public street and highway lighting | 2,247,000 | |
| Irrigation | | |
| Resale | 2,548,000 | |
| Maximum Peak Load | 419 | MW |

### GAS UTILITIES ONLY

| | | |
|---|---|---|
| Total number of customers | | |
| Residential | | |
| Commercial | | |
| Industrial | | |
| Irrigation | | |
| Resale | | |
| Total therms sold | | therms |
| Residential | | |
| Commercial | | |
| Industrial | | |
| Irrigation | | |
| Resale | | |

**VERIFICATION**
**AND**
**SWORN STATEMENT**
**Intrastate Revenues Only**

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APR 1 5 2008
AZ CORPORATION COMMISSION
DIRECTOR OF UTILITIES

**VERIFICATION**

| | |
|---|---|
| STATE OF Arizona | COUNTY OF (COUNTY NAME)<br>Pima |
| I, THE UNDERSIGNED | NAME (OWNER OR OFFICIAL) TITLE<br>Karen G. Kissinger, VP, Controller & CCO |
| OF THE | COMPANY NAME<br>UNS Electric, Inc. |

**DO SAY THAT THIS ANNUAL UTILITY REPORT TO THE ARIZONA CORPORATION COMMISSION**

| FOR THE YEAR ENDING | MONTH | DAY | YEAR |
|---|---|---|---|
| | 12 | 31 | 2007 |

**HAS BEEN PREPARED UNDER MY DIRECTION, FROM THE ORIGINAL BOOKS, PAPERS AND RECORDS OF SAID UTILITY; THAT I HAVE CAREFULLY EXAMINED THE SAME, AND DECLARE THE SAME TO BE A COMPLETE AND CORRECT STATEMENT OF BUSINESS AND AFFAIRS OF SAID UTILITY FOR THE PERIOD COVERED BY THIS REPORT IN RESPECT TO EACH AND EVERY MATTER AND THING SET FORTH, TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.**

**SWORN STATEMENT**

**IN ACCORDANCE WITH THE REQUIREMENT OF TITLE 40, ARTICLE 8, SECTION 40-401, ARIZONA REVISED STATUTES, IT IS HEREIN REPORTED THAT THE GROSS OPERATING REVENUE OF SAID UTILITY DERIVED FROM ARIZONA INTRASTATE UTILITY OPERATIONS DURING CALENDAR YEAR 2007 WAS:**

| Arizona Intrastate Gross Operating Revenues Only ($) |
|---|
| $ 181,230,818 |

**(THE AMOUNT IN BOX ABOVE INCLUDES $ 12,506,322 IN SALES AND FRANCHISE TAXES BILLED, OR COLLECTED)**

****REVENUE REPORTED ON THIS PAGE MUST INCLUDE SALES TAXES BILLED OR COLLECTED. IF FOR ANY OTHER REASON, THE REVENUE REPORTED ABOVE DOES NOT AGREE WITH TOTAL OPERATING REVENUES ELSEWHERE REPORTED, ATTACH THOSE STATEMENTS THAT RECONCILE THE DIFFERENCE. (EXPLAIN IN DETAIL)**

Karen G Kissinger
SIGNATURE OF OWNER OR OFFICIAL

520-745-3122
TELEPHONE NUMBER

SUBSCRIBED AND SWORN TO BEFORE ME

A NOTARY PUBLIC IN AND FOR THE COUNTY OF — COUNTY NAME: Pima

THIS 14th DAY OF — MONTH: April 2008

(SEAL)

Cheryl T. Gottshall
SIGNATURE OF NOTARY PUBLIC

MY COMMISSION EXPIRES 06/30/2010

Notary Public State of Arizona
Pima County
Cheryl T Gottshall
My Commission Expires
06/30/2010

VERIFICATION
AND
SWORN STATEMENT

**RESIDENTIAL REVENUE**

**INTRASTATE REVENUES ONLY**

RECEIVED
APR 1 5 2008
AZ CORPORATION COMMISSION
DIRECTOR OF UTILITIES

| | |
|---|---|
| STATE OF ARIZONA | COUNTY OF (COUNTY NAME)<br>Pima |
| I, THE UNDERSIGNED | NAME (OWNER OR OFFICIAL)<br>Karen G. Kissinger — TITLE<br>VP, Controller & CCO |
| OF THE | COMPANY NAME<br>UNS Electric, Inc. |

DO SAY THAT THIS ANNUAL UTILITY REPORT TO THE ARIZONA CORPORATION COMMISSION

| FOR THE YEAR ENDING | MONTH | DAY | YEAR |
|---|---|---|---|
| | 12 | 31 | 2007 |

HAS BEEN PREPARED UNDER MY DIRECTION, FROM THE ORIGINAL BOOKS, PAPERS AND RECORDS OF SAID UTILITY; THAT I HAVE CAREFULLY EXAMINED THE SAME, AND DECLARE THE SAME TO BE A COMPLETE AND CORRECT STATEMENT OF BUSINESS AND AFFAIRS OF SAID UTILITY FOR THE PERIOD COVERED BY THIS REPORT IN RESPECT TO EACH AND EVERY MATTER AND THING SET FORTH, TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.

## SWORN STATEMENT

IN ACCORDANCE WITH THE REQUIREMENTS OF TITLE 40, ARTICLE 8, SECTION 40-401.01, ARIZONA REVISED STATUTES, IT IS HEREIN REPORTED THAT THE GROSS OPERATING REVENUE OF SAID UTILITY DERIVED FROM ARIZONA INTRASTATE UTILITY OPERATIONS RECEIVED FROM RESIDENTIAL CUSTOMERS DURING CALENDAR YEAR 2007 WAS:

ARIZONA INTRASTATE GROSS OPERATING REVENUES

$ 92,784,192

(THE AMOUNT IN BOX AT LEFT INCLUDES $ 6,400,995 IN SALES AND FRANCHISE TAXES BILLED, OR COLLECTED

*RESIDENTIAL REVENUE REPORTED ON THIS PAGE MUST INCLUDE SALES TAXES BILLED.

X Karen G Kissinger
SIGNATURE OF OWNER OR OFFICIAL

520-745-3122
TELEPHONE NUMBER

Notary Public State of Arizona
Pima County
Cheryl T Gottshall
My Commission Expires
06/30/2010

SUBSCRIBED AND SWORN TO BEFORE ME

NOTARY PUBLIC NAME: Cheryl T. Gottshall

A NOTARY PUBLIC IN AND FOR THE COUNTY OF

COUNTY NAME: Pima

THIS 14th DAY OF

MONTH April 2008

(SEAL)

MY COMMISSION EXPIRES 06/30/2010

X Cheryl T. Gottshall
SIGNATURE OF NOTARY PUBLIC

# FINANCIAL INFORMATION

Attach to this annual report a copy of the companies' year-end (Calendar Year 2007) financial statements. If you do not compile these reports, the Utilities Division will supply you with blank financial statements for completion and filing. **ALL INFORMATION MUST BE ARIZONA-SPECIFIC AND REFLECT OPERATING RESULTS IN ARIZONA.**

# UNS Electric, Inc.

## Financial Statements

## Years Ended December 31, 2007 and 2006

UniSourceEnergy
SERVICES

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers LLP**
One North Wacker
Chicago, IL 60606
Telephone (312) 298 2000
Facsimile (312) 298 2001
www.pwc.com

## Report of Independent Auditors

To the Board of Directors and Stockholder of
UNS Electric, Inc.

In our opinion, the accompanying balance sheets and statements of capitalization and the related statements of income, cash flows and changes in stockholder's equity and comprehensive income present fairly, in all material respects, the financial position of UNS Electric, Inc. (the "Company) at December 31, 2007 and December 31, 2006 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chicago, Illinois
April 10, 2008

**UNS ELECTRIC, INC.**
**STATEMENTS OF INCOME**

| | Years Ended December 31, 2007 | 2006 |
|---|---|---|
| | - Thousands of Dollars - | |
| **Operating Revenues** | | |
| Electric Retail Sales | $ **165,146** | $ 157,836 |
| Electric Wholesale Sales | **234** | 245 |
| Other Revenues | **3,579** | 1,685 |
| **Total Operating Revenues** | **168,959** | 159,766 |
| **Operating Expenses** | | |
| Purchased Energy | **110,871** | 106,271 |
| Other Operations and Maintenance | **30,099** | 25,749 |
| Depreciation and Amortization | **13,021** | 11,210 |
| Taxes Other than Income Taxes | **3,475** | 3,373 |
| **Total Operating Expenses** | **157,466** | 146,603 |
| **Operating Income** | **11,493** | 13,163 |
| **Other Income** | | |
| Interest Income | **731** | 533 |
| Other | **1,386** | 40 |
| **Total Other Income** | **2,117** | 573 |
| **Interest Expense** | | |
| Long-Term Debt | **6,273** | 4,817 |
| Interest on Capital Leases | **22** | 29 |
| Allowance for Funds Used During Construction | **(740)** | (590) |
| Other | **167** | 1,013 |
| **Total Interest Expense** | **5,722** | 5,269 |
| **Income Before Income Taxes** | **7,888** | 8,467 |
| Income Taxes | **3,134** | 3,362 |
| **Net Income** | $ **4,754** | $ 5,105 |

See Notes to Financial Statements.

**UNS ELECTRIC, INC.**
**STATEMENTS OF CASH FLOWS**

| | Years Ended December 31, | |
|---|---|---|
| | 2007 | 2006 |
| | - Thousands of Dollars - | |
| **Cash Flows from Operating Activities** | | |
| Cash Receipts from Electric Sales | $ 178,109 | $ 167,412 |
| Interest Received | 288 | 15 |
| Other Cash Receipts | 1,231 | 1,397 |
| Purchased Energy Costs Paid | (107,621) | (103,813) |
| Payment of Other Operations and Maintenance Costs | (18,106) | (17,397) |
| Taxes Paid, Net of Amounts Capitalized | (16,403) | (15,433) |
| Interest Paid, Net of Amounts Capitalized | (5,618) | (4,753) |
| Income Taxes Paid | (4,769) | (8,274) |
| Wages Paid, Net of Amounts Capitalized | (4,859) | (4,869) |
| Other Cash Payments | (445) | (513) |
| **Net Cash Flows - Operating Activities** | 21,807 | 13,772 |
| **Cash Flows from Investing Activities** | | |
| Capital Expenditures | (37,582) | (38,947) |
| Proceeds from Sale of Land and Buildings | 1,376 | - |
| **Net Cash Flows - Investing Activities** | (36,206) | (38,947) |
| **Cash Flows from Financing Activities** | | |
| Proceeds from Borrowings under Revolving Credit Facility | 14,000 | 30,000 |
| Repayment of Borrowings under Revolving Credit Facility | (7,000) | (16,000) |
| Equity Investment from UniSource Energy Services | 10,000 | 10,000 |
| Customer Advance Receipts | 2,835 | 4,723 |
| Customer Advance Refunds | (919) | (1,070) |
| Payment of Debt Issuance Costs | (7) | (81) |
| Intercompany Repayments | (6,586) | (5,248) |
| Other Cash Payments | (85) | (86) |
| **Net Cash Flows - Financing Activities** | 12,238 | 22,238 |
| Net Decrease in Cash and Cash Equivalents | (2,161) | (2,937) |
| Cash and Cash Equivalents, Beginning of Period | 4,828 | 7,765 |
| **Cash and Cash Equivalents, End of Period** | $ 2,667 | $ 4,828 |

See Notes to Financial Statements.

UNS ELECTRIC, INC.
BALANCE SHEETS

| | | December 31, 2007 | | December 31, 2006 |
|---|---|---|---|---|
| | | - Thousands of Dollars - | | |
| **ASSETS** | | | | |
| **Utility Plant** | | | | |
| Plant in Service | $ | 204,700 | $ | 170,994 |
| Utility Plant under Capital Leases | | 706 | | 706 |
| Construction Work in Progress | | 14,395 | | 16,047 |
| **Total Utility Plant** | | 219,801 | | 187,747 |
| Less Accumulated Depreciation and Amortization | | (38,822) | | (30,393) |
| Less Accumulated Amortization of Capital Lease Assets | | (401) | | (310) |
| **Total Utility Plant - Net** | | 180,578 | | 157,044 |
| **Investments and Other Property** | | 629 | | - |
| **Current Assets** | | | | |
| Cash and Cash Equivalents | | 2,667 | | 4,828 |
| Trade and Other Accounts Receivable | | 11,198 | | 9,791 |
| Unbilled Accounts Receivable | | 8,145 | | 8,729 |
| Allowance for Doubtful Accounts | | (848) | | (139) |
| Receivable from Related Parties | | 243 | | 257 |
| Income Tax Receivable | | 787 | | 15 |
| Materials and Supplies | | 7,678 | | 7,838 |
| Energy Contracts - Derivative Assets | | 3,435 | | - |
| Regulatory Assets - Derivatives | | 708 | | - |
| Deferred Income Taxes | | 352 | | 477 |
| Interest Receivable-Other | | 67 | | - |
| Other | | 547 | | 272 |
| **Total Current Assets** | | 34,979 | | 32,068 |
| **Other Assets** | | | | |
| Energy Contracts - Derivative Assets | | 7,779 | | 3,394 |
| Deferred Income Taxes | | 4,294 | | 4,564 |
| Regulatory Assets - Derivatives | | 298 | | - |
| Regulatory Assets - Other | | 1,398 | | 1,409 |
| Preliminary Engineering | | 368 | | 580 |
| Unamortized Debt Discount and Expense | | 191 | | 395 |
| Other | | 4 | | 335 |
| **Total Other Assets** | | 14,332 | | 10,677 |
| **Total Assets** | $ | 230,518 | $ | 199,789 |

See Notes to Financial Statements.

UNS ELECTRIC, INC.
BALANCE SHEETS

| | | December 31, 2007 | | December 31, 2006 |
|---|---|---|---|---|
| | | - Thousands of Dollars - | | |
| **CAPITALIZATION AND OTHER LIABILITIES** | | | | |
| **Capitalization** | | | | |
| Common Stock Equity | $ | 79,789 | $ | 64,937 |
| Capital Lease Obligations | | 258 | | 347 |
| Long-Term Debt | | 26,000 | | 79,000 |
| **Total Capitalization** | | 106,047 | | 144,284 |
| **Current Liabilities** | | | | |
| Current Obligations under Capital Leases | | 97 | | 91 |
| Current Maturities of Long-Term Debt | | 60,000 | | - |
| Accounts Payable | | 13,158 | | 13,765 |
| Payable to Related Parties | | 3,395 | | 4,621 |
| Regulatory Liabilities - Derivatives | | 3,410 | | - |
| Customer Deposits | | 3,730 | | 3,866 |
| Taxes Accrued | | 3,325 | | 3,275 |
| Interest Accrued | | 1,890 | | 1,770 |
| Accrued Employee Expenses | | 741 | | 633 |
| Energy Contracts - Derivative Liabilities | | 733 | | - |
| Environmentally Friendly Portfolio Surcharge | | - | | 1,820 |
| Other | | 261 | | 115 |
| **Total Current Liabilities** | | 90,740 | | 29,956 |
| **Deferred Credits and Other Liabilities** | | | | |
| Customer Advances for Construction | | 12,103 | | 11,025 |
| Over Recovered Purchased Power Costs Regulatory Liabilities | | 9,287 | | 6,372 |
| Regulatory Liabilities - Derivatives | | 6,426 | | 3,216 |
| Net Cost of Removal for Interim Retirements Regulatory Liabilities | | 2,067 | | 1,520 |
| Deferred Employee Benefits | | 1,855 | | 2,822 |
| Deferred Reclamation Costs | | 328 | | 411 |
| Energy Contracts - Derivative Liabilities | | 1,651 | | |
| Other | | 14 | | 183 |
| **Total Deferred Credits and Other Liabilities** | | 33,731 | | 25,549 |
| **Total Capitalization and Liabilities** | $ | 230,518 | $ | 199,789 |

See Notes to Financial Statements.

**UNS ELECTRIC, INC.**
**STATEMENTS OF CAPITALIZATION**

| | | | December 31, 2007 | December 31, 2006 |
|---|---|---|---|---|
| | | | - Thousands of Dollars - | |
| **COMMON STOCK EQUITY** | | | | |
| Common Stock--No Par Value | | | $ 58,617 | $ 48,617 |
| | **2007** | **2006** | | |
| Shares Authorized | 1,000 | 1,000 | | |
| Shares Outstanding | 1,000 | 1,000 | | |
| Accumulated Earnings | | | 21,140 | 16,386 |
| Accumulated Other Comprehensive Income (Loss) | | | 32 | (66) |
| **Total Common Stock Equity** | | | 79,789 | 64,937 |
| **CAPITAL LEASE OBLIGATIONS** | | | | |
| Total Capital Lease Obligations | | | 355 | 439 |
| Less Current Maturities | | | (97) | (92) |
| **Total Long-Term Capital Lease Obligations** | | | 258 | 347 |
| **LONG-TERM DEBT** | | | | |
| **Issue** | **Maturity** | **Interest Rate** | | |
| Senior Unsecured Notes | 8/11/2008 | 7.61% | 60,000 | 60,000 |
| Credit Agreement - Revolving Credit Facility | 8/11/2011 | Variable* | 26,000 | 19,000 |
| Total Stated Principal Amount | | | 86,000 | 79,000 |
| Less Current Maturities | | | (60,000) | - |
| **Total Long-Term Debt** | | | 26,000 | 79,000 |
| **Total Capitalization** | | | $ 106,047 | $ 144,284 |

* Interest accrues at a rate of LIBOR plus 1.0% or the greater of the federal funds rate plus 0.5% or the agent bank's reference rate. The weighted average interest rate on borrowings under the UNS Gas / UNS Electric Revolver at December 31, 2007 was 5.89%.

See Notes to Financial Statements.

UNS ELECTRIC, INC.
STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME

| | Common Shares Outstanding | Common Stock | Accumulated Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholder's Equity |
|---|---|---|---|---|---|
| | | | - Thousands of Dollars - | | |
| **Balances at December 31, 2005** | **1,000** | **$ 38,617** | **$ 11,281** | **$ -** | **$ 49,898** |
| Comprehensive Income: | | | | | |
| 2006 Net Income | - | - | 5,105 | - | 5,105 |
| Total Comprehensive Income | | | | | 5,105 |
| Adjustment to Initially Recognize the Funded Status of Employee Benefit Plans (net of $43 income taxes) | - | - | - | (66) | (66) |
| Equity Contribution from UniSource Energy Services | - | 10,000 | - | - | 10,000 |
| **Balances at December 31, 2006** | **1,000** | **$ 48,617** | **$ 16,386** | **$ (66)** | **$ 64,937** |
| Comprehensive Income: | | | | | |
| 2007 Net Income | - | - | 4,754 | - | 4,754 |
| Decrease in Post-Retirement Medical Liability (net of $64 income taxes) | - | - | - | 98 | 98 |
| Total Comprehensive Income | | | | | 4,852 |
| Equity Contribution from UniSource Energy Services | - | 10,000 | - | - | 10,000 |
| **Balances at December 31, 2007** | **1,000** | **$ 58,617** | **$ 21,140** | **$ 32** | **$ 79,789** |

See Notes to Financial Statements.

## NOTE 1. NATURE OF OPERATIONS

UNS Electric, Inc. (UNS Electric) is an electric transmission and distribution company serving approximately 90,000 retail customers in Mohave and Santa Cruz counties. UniSource Energy Services, Inc. (UES), an intermediate holding company, owns all of the common stock of UNS Electric and UNS Gas, Inc. UniSource Energy Corporation (UniSource Energy) owns all of the common stock of UES.

References to "we" and "our" are to UNS Electric.

## NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF PRESENTATION

Our accounting policies conform to accounting principles generally accepted in the United States of America (GAAP), including the accounting principles for rate-regulated enterprises. Certain amounts reported in the prior year financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on Net Income.

### ACCOUNTING FOR RATE REGULATION

The Arizona Corporation Commission (ACC) and the Federal Energy Regulatory Commission (FERC) regulate portions of UNS Electric's utility accounting practices and electric rates. The ACC has authority over certain rates charged to retail customers, the issuance of securities, and transactions with affiliated parties. The FERC regulates UNS Electric's rates for wholesale power sales and interstate transmission services.

UNS Electric generally uses the same accounting policies and practices used by unregulated companies for financial reporting under GAAP. However, sometimes these principles, such as the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71), require special accounting treatment for regulated companies to show the effect of regulation. For example, in setting UNS Electric's retail rates, the ACC may not allow UNS Electric to currently charge our customers to recover certain expenses, but instead may require that these expenses be charged to customers in the future. In this situation, FAS 71 requires that UNS Electric defer these items and show them as regulatory assets on the balance sheet until we are allowed to charge our customers. UNS Electric then amortizes these items as expense to the income statement as those charges are recovered from customers. Similarly, certain revenue items may be deferred as regulatory liabilities, which are also eventually amortized to the income statement as rates to customers are reduced.

The conditions a regulated company must satisfy to apply the accounting policies and practices of FAS 71 include:

- an independent regulator sets rates;
- the regulator sets the rates to recover the specific costs of providing service; and
- the service territory lacks competitive pressures to reduce rates below the rates set by the regulator.

FAS 71 may, at some future date, be discontinued due to changes in the regulatory and competitive environments. If UNS Electric stopped applying FAS 71 to its regulated operations, it would write off the related balances of its regulatory assets as an expense and would write off its regulatory liabilities as income on its income statement. UNS Electric's cash flows would not be affected if it stopped applying FAS 71 unless a regulatory order limited its ability to recover the cost of its regulatory assets. We believe our electric operations continue to meet the criteria for FAS 71.

**UTILITY PLANT**

UNS Electric reports its utility plant at cost. Utility plant includes material and labor costs, contractor costs, construction overhead costs, and an allowance for funds used during construction (AFUDC). We charge maintenance and repairs to operating expense as incurred.

AFUDC represents the estimated cost of debt and equity funds that finance utility plant construction. We recover AFUDC in rates through depreciation expense over the useful life of the related asset. UNS Electric imputed the cost of capital on construction expenditures at an average rate of 13.51% for 2007 and 10.93% for 2006. The component of AFUDC attributable to borrowed funds is included as a reduction of Other Interest Expense on the income statement and totaled $0.7 million in 2007 and $0.6 million in 2006. The equity component is included in Interest Income and totaled $0.4 million in 2007 and $0.5 million in 2006.

We compute depreciation of utility plant on a straight-line basis over the service lives of the assets. The average annual depreciation rates for UNS Electric's utility plant were 4.60% in 2007 and 4.52% in 2006.

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

**MATERIALS AND SUPPLIES**

UNS Electric carries transmission and distribution materials and supplies in inventory at the lower of average cost or market.

**COMPUTER SOFTWARE COSTS**

UNS Electric capitalizes all costs incurred to purchase computer software and amortizes those costs over the estimated economic life of the product. We would immediately expense capitalized computer software costs if the software were determined to be no longer useful.

**DEBT**

We defer costs related to the issuance of debt. These costs include underwriters' commissions, discounts or premiums, and other costs such as legal, accounting and regulatory fees and printing costs. We amortize these costs over the life of the debt using the straight-line method, which approximates the effective interest method. Unamortized debt issuance costs were $0.2 million at December 31, 2007 and $0.4 million at December 31, 2006. See Note 5.

We report outstanding revolving credit balances as long-term debt when management has the intention and has the ability to roll-over outstanding balances for a period that is greater than one year.

## UTILITY OPERATING REVENUES

UNS Electric records revenues from customers when we provide services. Electric utility revenues include unbilled revenues which are earned (service has been provided) but not billed by the end of an accounting period. Unbilled sales are estimated for the month by reviewing the meter reading schedules and estimating the number of billed and unbilled kWhs for each billing cycle. Current month estimated unbilled kWhs are allocated by customer class. New unbilled revenue estimates are recorded and unbilled revenue estimates from the prior month are reversed.

We record an allowance for our estimate of revenues billed for which collection is doubtful. UNS Electric establishes an allowance for doubtful accounts based on historical experience and any specific customer collection issues.

Other Revenues primarily consists of miscellaneous fees, including service connection and late fees, and rental revenue from pole attachments.

## PURCHASED ENERGY COSTS

UNS Electric defers differences between purchased energy costs and the recovery of such costs in revenues. UNS Electric adjusts future billings for such deferrals through the use of a Purchased Power and Fuel Adjustment Clause (PPFAC) approved by the ACC. The PPFAC allows for a revenue surcharge or surcredit (that adjusts the customer's base rate for delivered purchased power) to collect or return under or over recovery of costs.

## RELATED PARTY TRANSACTIONS

UNS Electric receives certain corporate, operation and administrative support services from affiliates. These costs consist primarily of employee compensation and benefits. Services from Tucson Electric Power Company (TEP) totaled $4.5 million in 2007 and $4.9 million in 2006. Services from UNS Gas totaled $0.1 million in 2007 and in 2006. TEP, a regulated public utility serving retail electric customers in southern Arizona, is UniSource Energy's largest operating subsidiary. Southwest Energy Solutions, Inc., another UniSource Energy affiliate, charged UNS Electric $0.1 million in 2007 and $0.2 million in 2006 for meter reading services.

## INCOME TAXES

GAAP requires us to report some of our assets and liabilities differently in our financial statements than we do for income tax purposes. We report the tax effects of differences in these items as deferred income tax assets or liabilities in our balance sheet. We measure these tax assets and liabilities using current income tax rates.

UNS Electric is a member of the UniSource Energy consolidated income tax filing. UNS Electric is allocated income taxes based on its taxable income and deductions as reported in the UniSource Energy consolidated and/or combined tax return filings. The tax liability is allocated in accordance with the income tax regulations. As a result, the regular tax liability of UNS Electric is calculated on a stand alone basis and the liability is then owed to UniSource Energy through intercompany accounts. UniSource Energy has the ultimate responsibility for payment of consolidated tax liabilities to taxing authorities and maintaining intercompany tax accounts with its subsidiaries. The Alternative Minimum Tax (AMT) liability of UNS Electric is also computed in accordance with tax regulations. This method for allocating consolidated AMT among group members considers the contribution that one member's AMT attributes provide in offsetting the consolidated AMT liability that would otherwise result if the member were not included in the consolidated group.

## TAXES OTHER THAN INCOME TAXES

UNS Electric acts as a conduit or collection agent for excise tax (sales tax) as well as franchise fees and regulatory assessments. UNS Electric records liabilities payable to governmental agencies when it charges its customers for these amounts. Neither the amounts charged nor payable are reflected in the income statement.

## DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

UNS Electric applies Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, (FAS 133). Under FAS 133, all derivative instruments, except those meeting specific exceptions, are recognized in the balance sheet at their fair value. Changes in fair value are recognized immediately in earnings unless specific hedge accounting criteria are met. For derivatives that qualify for hedge accounting, depending on the nature of the hedge, changes in fair value are either offset by changes in the fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. At December 31, 2007 and December 31, 2006, UNS Electric had no derivatives accounted for as cash flow hedges.

UNS Electric purchases all of its electricity under a full requirements power supply agreement with Pinnacle West Marketing and Trading (PWMT) that will expire May 31, 2008. UNS Electric is in the process of replacing this energy resource for periods after May 2008. In order to reduce the risk of unfavorable changes in future power procurement prices, UNS Electric has entered into forward power purchase contracts for specified amounts of energy beginning in 2008 through 2013. The contracts are valued based on either fixed prices or indexed to natural gas prices as of December 31, 2007. UNS Electric has also hedged a portion of its total natural gas exposure from gas-indexed purchase power agreements that begin in June 2008 with fixed price contracts. In addition, UNS Electric began hedging a portion of its anticipated natural gas exposure from plant fuel for the period June 2008 and beyond.

UNS Electric's forward power purchase contracts meet the definition of a derivative and are required to be marked to market each reporting period. In December 2006, the ACC granted UNS Electric an accounting order to record the unrealized gains and losses as a regulatory asset or a regulatory liability. As these contracts settle, the actual costs of the power purchased are charged to the PPFAC.

The net unrealized gains and losses from UNS Electric's' forward power purchases and gas swaps reported in Regulatory Assets and Liabilities were as follows:

| | (Increase) Decrease recorded in | | Balance as of December 31, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | -Thousands of Dollars- | | | |
| Gas Swaps recorded in Current Regulatory Assets | **$ 708** | $ - | **$ 708** | $ - |
| Power Purchases recorded in Current Regulatory Liabilities | **(3,410)** | - | **(3,410)** | - |
| Gas Swaps recorded in Noncurrent Regulatory Assets | **298** | $ - | **298** | $ - |
| Power Purchases recorded in Noncurrent Regulatory Liabilities – Derivatives | **(3,210)** | (3,216) | **(6,426)** | (3,216) |
| Pre-Tax Unrealized Gain on Forward Power Purchases and Gas Swaps | **$(5,614)** | $(3,216) | **$(8,830)** | $(3,216) |

The fair value of UNS Electric's' derivative assets and liabilities were recorded as follows:

| | December 31, 2007 | | | December 31, 2006 | | |
|---|---|---|---|---|---|---|
| | Power Purchases | Gas Swaps | Total | Power Purchases | Gas Swaps | Total |
| | | | -Thousands of Dollars- | | | |
| Energy Contracts – Derivatives Assets - Current | **$3,410** | **$ 25** | **$3,435** | $ - | $ - | $ - |
| Energy Contracts – Derivative Liabilities - Current | **-** | **(733)** | **(733)** | - | - | - |
| Net Current Derivative Assets (Liabilities) | **$3,410** | **$ (708)** | **$2,702** | $ - | $ - | $ - |
| Energy Contracts – Derivatives Assets - Noncurrent | **$7,644** | **$ 135** | **$7,779** | $ 3,394 | $ - | $3,394 |
| Deferred Credits and Deferred Liabilities - Other | **(1,218)** | **(433)** | **(1,651)** | (178) | - | (178) |
| Net Noncurrent Derivative Assets (Liabilities) | **$6,426** | **$ (298)** | **$ 6,128** | $ 3,216 | $ - | $3,216 |
| Total Derivative Assets (Liabilities) | **9,826** | **$(1,006)** | **$ 8,830** | $ 3,216 | $ - | $3,216 |

Amounts presented as Current, are expected to be reclassified into the PPFAC within the next twelve months.

## FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of our current assets and liabilities approximate fair value because of the short maturity of these instruments.

UNS Electrics' senior unsecured note of $60 million outstanding at December 31, 2007 and December 31, 2006, had an estimated fair value of $60 million. This note, due August 11, 2008 is included in Current Liabilities in the UNS Electric balance sheet at December 31, 2007. UNS Electric determined the fair value of the senior unsecured note by calculating the present value of the cash flows of the note, using a discount rate consistent with market yields generally available as of December 31, 2007 and December 31, 2006 for bonds with similar characteristics with respect to credit rating and time-to-maturity. The use of different market assumptions and/or estimation methodologies may yield different estimated fair value amounts.

Borrowings under the revolving credit facility outstanding of $26 million at December 31, 2007 have an estimated fair value of $26 million. UNS Electric considers the principal amounts of variable rate debt to be a reasonable estimate of their fair value.

## EVALUATION OF ASSETS FOR IMPAIRMENT

UNS Electric evaluates its Utility Plant and other long-lived assets for impairment whenever events or circumstances occur that may indicate the carrying value of the assets may be impaired. If the fair value of the asset determined based on the undiscounted expected future cash flows from the long-lived asset is less than the carrying value of the asset, an impairment would be recorded.

## ASSET RETIREMENT OBLIGATIONS

FASB Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (FAS 143) requires entities to record the fair value of a liability for a legal obligation to retire an asset in the period in which the liability is incurred. FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), requires entities to record the fair value of a liability regarding a legal obligation to perform asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. We record a liability when we are able to reasonably estimate the fair value of any future obligation to retire as a result of an existing or enacted law, statute, ordinance or contract. We also record a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. When the liability is initially recorded, we capitalize a cost by increasing the carrying amount of the related long-lived asset. Over time, we adjust the liability to its present value by recognizing accretion expense as an operating expense in the income statement each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, we either settle the obligation for its recorded amount or incur a gain or loss if the actual costs differ from the recorded liability amount.

## NEW ACCOUNTING STANDARDS

- FAS 160, Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, issued December 2007, will change the accounting and reporting for minority interests, requiring such amounts to be classified as a component of equity, and will also change the accounting for transactions with minority-interest holders. The standard will be applicable for fiscal years beginning on or after December 15, 2008 on a prospective basis. Early adoption is prohibited and business combinations with acquisition dates prior to the effective date will not be adjusted upon application. We do not expect this pronouncement to have a material impact on our financial statements.

- FAS 141(R) Business Combinations - a replacement of FAS No. 141, issued December 2007, requires companies to record acquisitions at fair value. FAS 141(R) changes the definition of a business and a business combination and is generally expected to increase the number of transactions that will need to be accounted for at fair value. The standard will be applicable for fiscal years beginning on or after December 15, 2008 and generally on a prospective basis. Early adoption is prohibited and business combinations with acquisition dates prior to the effective date will not be adjusted upon application. We do not expect this pronouncement to have a material impact on our financial statements.

- FSP FASB Interpretation (FIN) 39-1, issued April 2007, allows entities that are party to a master netting arrangement to offset the receivable or payable recognized upon payment or receipt of cash collateral against fair value amounts recognized for derivative instruments that have been offset under the same master netting arrangement. Upon adoption of FSP FIN 39-1, an entity is required to make an accounting policy decision to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. FSP FIN 39-1 became effective January 1, 2008. We will continue to present cash collateral and derivatives assets and liabilities separately in our financial statements.

- FAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, issued February 2007, provides companies with the option of measuring certain financial assets and liabilities and other items at fair value with changes in fair value recognized in earnings as those changes occur. FAS 159 also establishes disclosure requirements that include displaying the fair value of those assets and liabilities for which the entity elects the fair value option on the face of the balance sheet and providing management's reasons for electing the fair value option for each item. We have not elected fair value accounting for any of our eligible financial instruments.

- FAS 157, Fair Value Measurement, issued September 2006, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS 157 clarifies that the exchange price is the price in the principal market in which the reporting entity would transact for the asset or liability. The implementation of FAS 157 on January 1, 2008 had no impact on our financial statements. We will begin disclosing inputs to develop fair value measurements and the effect of any of our assumptions on earnings or net assets for the year ending December 31, 2008.

- The Pension Protection Act of 2006 (Pension Act) became effective January 1, 2008. The new law affects the manner in which many companies, including UES administer their pension plans. The Pension Act resulted in no additional funding requirements for UNS Electric.

## USE OF ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## CONCENTRATION OF CREDIT RISK

As of December 31, 2007, UNS Electric had a total credit exposure related to its forward power purchase contracts and gas hedging activities of $7 million, primarily related to its relationship with four counterparties. Counterparty credit exposure is calculated by adding any outstanding receivables (net of amounts payable if a netting agreement exists) to the mark-to-market value of any forward contracts.

## NOTE 3. REGULATORY MATTERS

### Energy Cost Adjustment Mechanism

UNS Electric's retail rates include a PPFAC, which allows for a separate surcharge or surcredit to the base rate for delivered purchased power to collect or return under- or over-recovery of costs. The ACC approved a PPFAC surcharge of $0.01825 per kWh to recover transmission costs and the cost of the current full-requirements power supply agreement with PWMT.

### General Rate Case Filing

In December 2006, UNS Electric filed a general rate case (on a cost of service basis) with the ACC requesting a total rate increase of 5.5% to cover a revenue deficiency of $9 million. The increase is necessary because of the growth in UNS Electric's service territory and the related increase in capital expenditures and operating costs.

UNS Electric expects the ACC to rule on its rate case in 2008.

UNS Electric also requested that a new PPFAC mechanism would take effect when the current power supply agreement with PWMT expires in May 2008. The new PPFAC mechanism would utilize a forward looking projection of gas and purchased power costs.

### Regulatory Assets and Liabilities

UNS Electric's regulatory assets and liabilities were as follows:

| | December 31, | |
|---|---|---|
| | **2007** | **2006** |
| | -Thousands of Dollars- | |
| **Current Regulatory Assets** | | |
| Derivatives | **$ 708** | $ - |
| **Other Regulatory Assets** | | |
| Rate Case Costs | **600** | - |
| Deferred Environmental Portfolio Surcharge | **132** | - |
| Derivatives | **298** | - |
| Pension Assets | **665** | 1,409 |
| **Total Other Regulatory Assets** | **$1,695** | $ 1,409 |
| **Current Regulatory Liabilities** | | |
| Derivatives | **$3,410** | $ - |
| Deferred Environmental Portfolio Surcharge | **-** | 1,820 |
| **Other Regulatory Liabilities** | | |
| Over Recovered Purchase Power Costs | **9,286** | 6,372 |
| Derivatives | **6,426** | 3,216 |
| Net Cost of Removal for Interim Retirements | **2,067** | 1,520 |
| **Total Regulatory Liabilities** | **$ 21,189** | $ 12,928 |

Regulatory assets are either being collected in rates or are expected to be collected through rates in a future period, as described below:

- Pension Assets were recorded in 2006 as based on past regulatory actions, UNS Electric expects to recover in rates the UNS Electric portion of the underfunded pension plan for UNS Electric employees. UNS Electric does not earn a return on these costs.

- UNS Electric has requested recovery of costs associated with its 2006 rate case filing. Historically, the ACC has allowed recovery of rate case costs. The recovery period will be determined when the ACC rules on UNS Electric's rate case in 2008. UNS Electric does not earn a return on these costs.

Regulatory liabilities represent items that UNS Electric expects to pay to customers through billing reductions in future periods or use for the purpose for which they were collected from customers, as described below:

- Deferred Environmental Friendly Portfolio Surcharge represents amounts the ACC has authorized UNS Electric to collect, through customer billings, for environmental improvement projects. A regulatory asset exists when the cost of environmental improvement projects exceeds customer collections and a regulatory liability exists when customer collections exceed environmental project costs.

- UNS Electric defers differences between purchased energy costs and the recovery of such costs in revenues. Future billings are adjusted for such deferrals through use of a Purchased Power and Fuel Adjustment Clause (PPFAC) approved by the ACC. The PPFAC allows for a revenue surcharge or surcredit (that adjusts the customer's rate for delivered purchased power) to collect or return under- or over-recovery of costs.

- In December 2006, the ACC granted UNS Electric an Accounting Order authorizing regulatory deferral of changes in the fair value of derivative contracts that are required to be marked-to-market under GAAP.

- Net cost of Removal for Interim Retirements represents an estimate of future asset retirement obligations.

**Income Statement Impact of Applying FAS 71**

If UNS Electric had not applied FAS 71, net income would have been less than $1 million higher in 2007 and $3 million higher in 2006, as UNS Electric would have been able to recognize over-recovered purchased power costs as a credit to the income statement rather than record an increase to regulatory liabilities.

**Future Implications of Discontinuing Application of FAS 71**

UNS Electric regularly assesses whether it can continue to apply FAS 71 to its operations. If UNS Electric stopped applying FAS 71 to its regulated operations, it would write-off the related balances of its regulatory assets as an expense and would write-off its regulatory liabilities as income on its income statement. Based on the regulatory asset and liability balances, if UNS Electric had stopped applying FAS 71 to its regulated operations, it would have recorded an extraordinary after-tax gain of $11 million at December 31, 2007. Discontinuing application of FAS 71 would not affect UNS Electric's cash flows.

## NOTE 4. UTILITY PLANT

The following table shows Utility Plant in Service and depreciable lives by major class at December 31:

| | 2007 | 2006 | Depreciable Lives |
|---|---|---|---|
| | -Thousands of Dollars- | | |
| Plant in Service: | | | |
| Electric Generation Plant | $ 16,650 | $ 17,315 | 23 – 40 years |
| Electric Distribution Plant | 143,132 | 118,562 | 14 – 26 years |
| Electric Transmission Plant | 28,179 | 18,302 | 11 – 45 years |
| General Plant | 9,371 | 9,440 | 7 – 33 years |
| Intangible Plant | 7,368 | 7,375 | 5 – 25 years |
| **Total Plant in Service** | $204,700 | $170,994 | |
| **Utility Plant under Capital Leases** | $ 706 | $ 706 | |

Intangible Plant primarily represents transmission access and computer software costs.

## NOTE 5. DEBT AND CAPITAL LEASE OBLIGATIONS

### SENIOR UNSECURED NOTES

UNS Electric has $60 million of 7.61% senior unsecured notes outstanding due August 1, 2008 that are guaranteed by UES. The senior unsecured note agreements for UNS Electric contain certain restrictive covenants, including restrictions on transactions with affiliates, mergers, liens to secure indebtedness, restricted payments, incurrence of indebtedness, and minimum net worth. Consolidated Net Worth, as defined by the senior unsecured note agreements for UNS Electric, is approximately equal to the balance sheet line item, Common Stock Equity. The table below outlines the actual and required minimum net worth levels of UES and UNS Electric at December 31, 2007.

At December 31, 2007, the UNS Electric $60 million senior unsecured note, due August 1, 2008, is included in Current Liabilities in the balance sheet. UNS Electric expects to refinance the maturing debt with a new debt issuance prior to August 2008.

| | Required Minimum Net Worth | Actual Net Worth |
|---|---|---|
| | -Thousands of Dollars- | |
| UES | $ 50,000 | $168,327 |
| UNS Electric | 26,000 | 79,789 |

The incurrence of indebtedness covenant requires UNS Electric to meet certain tests before additional indebtedness may be incurred. These tests include:

- A ratio of Long-Term Debt to Total Capitalization of no greater than 65%.
- An Interest Coverage Ratio (a measure of cash flow to cover interest expense) of at least 2.50 to 1.00.

However, UNS Electric may, without meeting these tests, refinance indebtedness and incur short-term debt in an amount not to exceed $5 million. UNS Electric may not declare or make distributions or dividends (restricted payments) on its common stock unless (a) immediately after giving effect to such action no default or event of default would exist under its senior unsecured note agreement and (b) immediately after giving effect to such action, it would be permitted to incur an additional dollar of indebtedness under the debt incurrence test. As of December 31, 2007, UNS Electric was in compliance with the terms of the senior unsecured note agreement.

The senior unsecured notes may be accelerated upon the occurrence and continuance of an event of default under the senior unsecured note agreement. Events of default include failure to make payments required thereunder, certain events of bankruptcy or commencement of similar liquidation or reorganization proceedings or a change of control of UES or UNS Electric. In addition, an event of default may occur if UNS Electric, UES or UNS Gas default on any payments required in respect of certain indebtedness that is outstanding in an aggregate principal amount of at least $4 million or if any such indebtedness becomes due or capable of being called for payment prior to its scheduled payment date or if there is a default in the performance or compliance with the other terms of such indebtedness and, as a result of such default, such indebtedness has become, or has been declared, due and payable, prior to its scheduled payment date.

## CAPITAL LEASE OBLIGATIONS

UNS Electric has two trucks under capital lease with an initial term to 2011. Both leases may be continued with the same rental terms until either party gives 90 days notice and provide for the purchase of the leased asset at fair market value at the end of the lease.

The following provides future payments on UNS Electric's capital lease obligations at December 31, 2007:

| | **Capital Lease Obligations** |
|---|---|
| | -Thousands of Dollars- |
| 2008 | $ 115 |
| 2009 | 115 |
| 2010 | 115 |
| 2011 | 38 |
| 2011 | - |
| Total 2007-2011 | 383 |
| Thereafter | - |
| Imputed Interest | (28) |
| **Total** | $ 355 |

## REVOLVING CREDIT AGREEMENT

The UNS Gas/UNS Electric Revolver is a $60 million revolving credit facility which matures in August 2011. Either UNS Gas or UNS Electric may borrow up to a maximum of $45 million, so long as the combined amount borrowed does not exceed $60 million. UNS Gas is only liable for UNS Gas' borrowings, and similarly, UNS Electric is only liable for UNS Electric's borrowings under the UNS Gas/UNS Electric Revolver. UES guarantees the obligations of both UNS Gas and UNS Electric.

UNS Gas and UNS Electric each have the option of paying interest at LIBOR plus 1.0% or the greater of the federal funds rate plus 0.5% or the agent bank's reference rate.

The UNS Gas/UNS Electric Revolver contains restrictions on additional indebtedness, liens, mergers and sales of assets. The UNS Gas/UNS Electric Revolver also contains a maximum leverage ratio and a minimum cash flow to interest coverage ratio for each borrower. As of December 31, 2007, UNS Gas and UNS Electric were each in compliance with the terms of the UNS Gas/UNS Electric Revolver.

As of December 31, 2007, UNS Electric had $26 million of borrowings outstanding under the UNS Gas/UNS Electric Revolver included in Long-Term Debt in the balance sheets. As of December 31, 2006, UNS Electric had $19 million of borrowings outstanding under the UNS Gas/UNS Electric Revolver.

## NOTE 6. COMMITMENTS AND CONTINGENCIES

We record liabilities for loss contingencies, including environmental remediation costs, arising from claims, assessments, litigation, fines and penalties and other sources when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated.

### ENERGY AND TRANSPORTATION COMMITMENTS

UNS Electric imports the power it purchases over the Western Area Power Administration's (WAPA) transmission lines. UNS Electric's transmission capacity agreements with WAPA provide for annual rate adjustments and expire in February 2008, June 2011, and May 2017. UNS Electric made payments under these contracts of $7 million in 2007, and $8 million in 2006.

UNS Electric's all requirements contract expires in 2008. During 2006 and 2007, UNS Electric entered into agreements to purchase power beginning in 2008 through 2013. The contracts are valued based on either fixed prices or indexed to natural gas prices at December 31, 2007. UNS Electric may purchase additional requirements on the spot market.

At December 31, 2007, UNS Electric estimates its future minimum payments under these contracts to be:

| | Purchase Obligations |
|---|---|
| | -Thousands of Dollars- |
| 2008 | $ 61,528 |
| 2009 | 69,680 |
| 2010 | 41,834 |
| 2011 | 16,565 |
| 2012 | 8,432 |
| Total 2008 – 2012 | 198,039 |
| Thereafter | 8,404 |
| **Total** | $206,443 |

### OPERATING LEASES

UNS Electric has entered into operating leases, primarily for office facilities and office equipment, with varying terms, provisions, and expiration dates.

UNS Electric's estimated future minimum payments under non-cancelable operating leases at December 31, 2007 were:

| | Operating Leases |
|---|---|
| | -Thousands of Dollars- |
| 2008 | $ 396 |
| 2009 | 319 |
| 2010 | 269 |
| 2011 | 269 |
| 2012 | 77 |
| Total 2008-2012 | 1,330 |
| Thereafter | 83 |
| **Total** | $ 1,413 |

UNS Electric's operating lease expense was $0.4 million in 2007 and $0.5 million in 2006.

**ENVIRONMENTAL CONTINGENCIES**

UNS Electric owns and operates the Valencia Power Plant (Valencia), located in Nogales, Arizona. The Valencia plant consists of three gas and diesel-fueled combustion turbine units, with a fourth unit that commenced operations in June 2006. UNS Electric has continued efforts initiated by the site's previous owner to remediate the soil and groundwater contamination at its Valencia facility. We estimate the cost of remediation to total approximately $0.6 million. The ultimate cost, however, will depend on the extent of contamination found as the project progresses and when final remediation occurs. We expect decontamination to be substantially completed within five years. Under the purchase agreement for Valencia, UNS Electric's obligation is limited to $1.5 million. At December 31, 2007, UNS Electric had a liability of $0.3 million included in Other Deferred Credits and Other Liabilities on the balance sheet.

## NOTE 7. INCOME AND OTHER TAXES

**INCOME TAXES**

We record deferred tax liabilities for amounts that will increase income taxes on future tax returns. We record deferred tax assets for amounts that could be used to reduce income taxes on future tax returns. UNS Electric determined that a valuation allowance on the deferred income tax assets for the 2007 and 2006 was not necessary. We reached this conclusion based on our interpretation of tax rules, tax planning strategies, scheduled reversals of temporary differences, and projected future taxable income.

UniSource Energy includes UNS Electric's taxable income in its consolidated federal income tax return. Deferred tax assets (liabilities) consist of the following:

| | 2007 | 2006 |
|---|---|---|
| | -Thousands of Dollars- | |
| **Gross Deferred Income Tax Liabilities** | | |
| Plant | **$ (5,648)** | $ (3,413) |
| Other | **(238)** | (850) |
| Gross Deferred Income Tax Liabilities | **(5,886)** | (4,263) |
| **Gross Deferred Income Tax Assets** | | |
| Alternative Minimum Tax Credit (AMT) | **374** | 374 |
| Customer Advances | **4,516** | 4,374 |
| Contributions in Aid of Construction | **1,287** | 1,233 |
| Purchased Power and Fuel Adjustment Clause | **3,644** | 2,523 |
| Compensation and Benefits | **455** | 435 |
| Other | **256** | 365 |
| Gross Deferred Income Tax Assets | **10,532** | 9,304 |
| **Net Deferred Income Tax Assets (Liabilities)** | **$ 4,646** | $ 5,041 |

The net deferred income tax asset (liability) is included in the balance sheet in the following accounts:

| | 2007 | 2006 |
|---|---|---|
| | -Thousands of Dollars- | |
| Deferred Income Taxes – Current Assets | **$ 352** | $ 477 |
| Deferred Income Taxes – Noncurrent Assets | **4,294** | 4,564 |
| **Net Deferred Income Tax Asset (Liability)** | **$ 4,646** | $ 5,041 |

Income tax expense (benefit) included in the income statement includes amounts both payable currently and deferred for payment in future periods as indicated below:

| | 2007 | 2006 |
|---|---|---|
| | -Thousand of Dollars- | |
| Current Tax Expense (Benefit) | | |
| Federal | **$ 2,513** | $ 5,189 |
| State | **470** | 934 |
| Deferred Tax Expense (Benefit) | | |
| Federal | **47** | (2,437) |
| State | **105** | (324) |
| **Total Federal and State Income Tax Expense** | **$ 3,135** | $ 3,362 |

The following reconciles the provision for income taxes at the federal statutory rate of 35% to the effective rate:

| | 2007 | 2006 |
|---|---|---|
| | -Thousands of Dollars- | |
| **Federal Income Tax Expense at Statutory Rate** | **$ 2,760** | $ 2,963 |
| State Income Tax Expense, Net of Federal Deduction | **364** | 391 |
| Other | **10** | 8 |
| **Total Federal and State Income Tax Expense** | **$ 3,134** | $ 3,362 |

**UNCERTAIN TAX POSITIONS**

FIN 48, Accounting for Uncertainty in Income Taxes – An Interpretation of FAS 109 (FIN 48) issued July 2006, requires us to determine whether it is "more likely than not" that we will sustain a tax position under examination. Such a position is measured to determine the amount of benefit to recognize in the financial statements. UNS Electric adopted the provisions of FIN 48 on January 1, 2007. The cumulative effect of applying this interpretation was no impact to retained earnings and the recognition of a $0.2 million uncertain tax receivable. As of December 31, 2007 the receivable has been recognized due to a settlement with the taxing authorities. During the year, no liability was recorded relating to tax positions taken in the current or prior years. It is not anticipated that unrecognized tax benefits will increase in the next 12 months. Tax years 2004 through 2006 are open under Federal and Arizona statues.

**OTHER TAX MATTERS**

On its 2003 and 2004 tax returns, UNS Electric elected to utilize an accounting method relating to the capitalization of indirect costs to production activities and self-constructed assets.

In August 2005, the Internal Revenue Service (IRS) issued a ruling limiting the ability of electric and gas utilities to use the new accounting method. As a result, UNS Electric amended its 2003 and 2004 federal and state tax returns to remove the benefit previously claimed using the accounting method. In 2006, UNS Electric remitted tax and interest of $1.3 million to the IRS and state tax authorities. Based on the settlement guidelines relating to the accounting method that were issued by the IRS in March 2007, UNS Electric has settled this issue with the IRS. UNS Electric anticipates receiving $0.6 million of taxes and interest during 2008 which will have no impact on the overall tax provision or on net income.

**OTHER TAXES**

UNS Electric acts as a conduit or collection agent for excise tax (sales tax) as well as franchise fees and regulatory assessments. It records liabilities payable to governmental agencies when it bills its customers for these amounts. Neither the amounts billed nor payable are reflected in the income statement.

## NOTE 8. PENSION AND POSTRETIREMENT BENEFIT PLANS

UNS Electric does not maintain a separate pension plan or other postretirement benefit plan for its employees. All regular employees are eligible to participate in the pension plan maintained by our parent, UES. A small group of active employees are also eligible to participate in a postretirement medical benefit plan. UES allocates net periodic benefit cost based on service cost for participating employees.

**PENSION PLAN**

The noncontributory, defined benefit pension plan provides benefits based on years of service and the employee's average compensation. UNS Electric funds the plan by contributing its allocable share of at least the minimum amount required under IRS regulations.

In 2008, UNS Electric expects to contribute $0.6 million to the pension plan.

## OTHER POSTRETIREMENT BENEFIT PLAN

UNS Electric assumed a $1.3 million liability for postretirement medical benefits for current retirees and a small group of active employees at the acquisition of the Arizona electric system assets. The select active employees participate in a Postretirement Benefit Plan covering employees of UniSource Energy.

## INCREMENTAL EFFECT OF APPLYING FAS 158

As a result of adopting FAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158), in December 2006, UNS Electric must recognize its allocable share of the underfunded status of the defined benefit pension and other postretirement plans as a liability. The underfunded status is measured as the difference between the fair value of the plan's assets and the projected benefit obligation for the pension plan or accumulated postretirement benefit obligation for the other postretirement benefit plan. The initial adjustment required to recognize the pension liability on adoption of this statement resulted in recognition of a regulatory asset. UNS Electric recorded its share of the required increase in the other postretirement obligation as an adjustment to Accumulated Other Comprehensive Loss as the ACC allows UNS Electric to recover other postretirement costs through rates only as benefit payments are made.

The following table presents the incremental effect of applying FAS 158, in combination with FAS 71, on individual line items in UNS Electric's balance sheet at December 31, 2006:

| UNS Electric Balance Sheet Line Items: | Preliminary Balances at December 31, 2006 Before Application of FAS 158 | FAS 158 Adjustment | Balances at December 31, 2006 After Application of FAS 158 |
|---|---|---|---|
| | | -Thousands of Dollars- | |
| Regulatory Assets | $ 10 | $1,399 | $ 1,409 |
| Deferred Income Taxes - Noncurrent | 4,521 | 43 | 4,564 |
| Total Assets | 198,347 | 1,442 | 199,789 |
| Deferred Employee Benefits | 1,313 | 1,509 | 2,822 |
| Total Deferred Credits and Other Liabilities | 24,040 | 1,509 | 25,549 |
| Accumulated Other Comprehensive Loss (Net of Tax) | - | (66) | (66) |
| Total Stockholders' Equity | 65,003 | (66) | 64,937 |

After the adoption of FAS 158 and before applying the provisions of FAS 71, UNS Electric had an accumulated comprehensive loss balance (net of tax) of $0.9 million attributable to its share of pension and other postretirement benefit obligations. UNS Electric subsequently recorded a regulatory pension asset of $1.4 million and an offsetting reduction on an after-tax basis of accumulated other comprehensive loss of $0.8 million, representing a reasonable approximation of UNS Electric's share of the pension plan's actuarial losses and prior service costs that are probable of recovery in rates by its regulated operations in future periods.

The pension and other postretirement benefit related amounts (excluding tax balances) included in UNS Electric's balance sheet are:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | Years Ended December 31, | | | |
| | 2007 | 2006 | 2007 | 2006 |
| | -Thousands of Dollars- | | | |
| Regulatory Pension Asset included in Regulatory Assets | **$ 663** | $ 1,399 | **$ -** | $ - |
| Accrued Benefit Liability included in Accrued Employee Expenses | **-** | - | **(75)** | (90) |
| Accrued Benefit Liability included in Deferred Employee Benefits | **(1,180)** | (1,775) | **(584)** | (953) |
| Accumulated Other Comprehensive Loss | **-** | - | **(52)** | 110 |
| Net Amount Recognized | **$ (517)** | $ (376) | **$ (711)** | $ (933) |

## OBLIGATIONS AND FUNDED STATUS

The actuarial present values of all pension benefit obligations and other postretirement benefit plans were measured at December 1. FAS 158 requires the measurement date to be changed to the end of the year effective December 31, 2008. The tables below reflect UES' plan information as a whole. The change in projected benefit obligation and plan assets and reconciliation of the funded status are as follows:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | Years Ended December 31, | | | |
| | 2007 | 2006 | 2007 | 2006 |
| | -Thousands of Dollars- | | | |
| **Change in Projected Benefit Obligation** | | | | |
| Benefit Obligation at Beginning of Year | **$ 7,461** | $ 6,104 | **$ 1,658** | $ 1,709 |
| Actuarial (Gain) Loss | **(1,417)** | 292 | **(275)** | 173 |
| Interest Cost | **440** | 360 | **91** | 94 |
| Service Cost | **1,017** | 958 | **-** | - |
| Benefits Paid | **(149)** | (253) | **(320)** | (275) |
| Amendment | **-** | - | **-** | (43) |
| **Projected Benefit Obligation at End of Year** | **7,352** | 7,461 | **1,154** | 1,658 |
| **Change in Plan Assets** | | | | |
| Fair Value of Plan Assets at Beginning of Year | **3,865** | 2,543 | **-** | - |
| Actual Return on Plan Assets | **173** | 425 | **-** | - |
| Benefits Paid | **(149)** | (253) | **(320)** | (315) |
| Contributions | **1,000** | 1,150 | **320** | 315 |
| **Fair Value of Plan Assets at End of Year** | **4,889** | 3,865 | **-** | - |
| **Funded Status at End of Year** | **$ (2,463)** | $(3,596) | **$ (1,154)** | $ (1,658) |

At December 31, 2007, UNS Electric's proportionate share of the pension plan's funded status is approximately 48%.

The following table provides the components of UES' accumulated other comprehensive loss and regulatory assets that have not been recognized as components of periodic benefit cost as of December 31, 2007:

| | Pension Benefits | Other Postretirement Benefits |
|---|---|---|
| | -Thousands of Dollars- | |
| Net (Gain) Loss | $ (976) | $ (62) |
| Prior Service Cost (Benefit) | 2,281 | (40) |

The accumulated benefit obligation for the UES defined benefit pension plan was $4.5 million at December 31, 2007 and $4.2 million at December 31, 2006. Changes in actuarial assumptions including an increase in the discount rate impacted the accumulated benefit obligation.

The components of net periodic benefit costs and other amounts recognized in other comprehensive income are as follows:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | -Thousands of Dollars- | | | |
| **Components of Net Periodic Cost** | | | | |
| Service Cost | $1,017 | $ 958 | $ - | $ - |
| Interest Cost | 440 | 360 | 90 | 94 |
| Expected Return on Plan Assets | (318) | (264) | - | - |
| Prior Service Cost Amortization | 258 | 258 | (3) | - |
| Recognized Actuarial (Gain) Loss | - | - | 4 | (12) |
| **Net Periodic Benefits Cost** | $1,397 | $ 1,312 | $ 91 | $ 82 |

In 2007, UNS Electric recognized 46% of total net periodic pension benefit costs and 44% of other postretirement benefit costs based on relative employee participation.

The amounts recognized in Other Comprehensive Income (OCI) or as regulatory assets are as follows:

| | Pension Benefits | | | |
|---|---|---|---|---|
| | 2007 | | 2006 | |
| | Regulatory Asset | OCI | Regulatory Asset | OCI |
| | -Thousands of Dollars | | | |
| **Changes in Plan Assets and Benefit Obligations Recognized in OCI or as Regulatory Assets** | | | | |
| Current Year Actuarial (Gain) Loss | $ (1,271) | $ - | $ - | $ - |
| Amortization of Actuarial Gain (Loss) | (258) | - | - | - |
| Prior Service (Cost) Amortization | - | - | - | - |
| Change in Additional Minimum Liability | - | - | - | - |
| Total Recognized in OCI or as Regulatory Assets | $ (1,529) | $ - | $ - | $ - |

| | Other Postretirement Benefits | |
|---|---|---|
| | 2007 | 2006 |
| | -Thousands of Dollars | |
| **Changes in Benefit Obligation Recognized in OCI** | | |
| Current Year Actuarial (Gain) Loss | $ (274) | $ - |
| Amortization of Actuarial Gain (Loss) | (4) | - |
| Prior Service Cost (Credit) | - | - |
| Prior Service (Cost) Amortization | 3 | - |
| **Total Recognized in OCI** | $ (275) | $ - |

UNS Electric recognized changes in benefit obligations in OCI of $0.2 million before tax. The after-tax impact in OCI of changes in benefit obligations in OCI was $0.1 million.

For the pension plan, prior service costs are amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan. UES will amortize $0.3 million of prior service cost from regulatory assets into net periodic benefit cost in 2008. The estimated net loss and prior service benefit for the defined benefit postretirement plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2008 are less than $0.1 million, respectively.

| Weighted-Average Assumptions Used to Determine Benefit Obligations as of December 1, | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Discount Rate | **6.80%** | 5.90% | **6.50%** | 5.60% |
| Rate of Compensation Increase | **3.00 – 4.00%** | 3.00 – 4.00% | - | - |

| Weighted-Average Assumptions Used to Determine Net Periodic Benefit Costs for Period Ended December 31, | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Discount Rate | **5.90%** | 5.90% | **5.60%** | 5.80% |
| Rate of Compensation Increase | **3.00 – 4.00%** | 3.00 – 4.00% | - | - |
| Expected Return on Plan Assets | **8.30%** | 8.30% | - | - |

Net periodic benefit cost is subject to various assumptions and determinations, such as the discount rate, the rate of compensation increase, and the expected return on plan assets. We estimated the expected return on plan assets based on a review of the plans' asset allocations. We also consulted with a third-party investment consultant and the plans' actuary who consider factors such as:

- market and economic indicators
- historical market returns
- correlations and volatility
- central banks' and government treasury departments' forecasts and objectives, and
- recent professional or academic research.

Changes that may arise over time with regard to these assumptions and determinations will change amounts recorded in the future as net periodic benefit cost.

| | December 31, 2007 | 2006 |
|---|---|---|
| **Assumed Health Care Cost Trend Rates** | | |
| Health Care Cost Trend Rate Assumed for Next Year (Pre-65) | **8%** | 9% |
| Health Care Cost Trend Rate Assumed for Next Year (Post-65) | **10%** | 11% |
| Ultimate Health Care Cost Trend Rate Assumed | **5%** | 5% |
| Year that the Rate Reaches the Ultimate Trend Rate | **2013** | 2013 |

A one-percentage-point change in assumed health care cost trend rates would have an impact of less than $0.1 million on the December 31, 2007 amounts reported.

**Pension Plan Assets**

UES calculates the market-related value of plan assets using the fair value of plan assets on the measurement date. The pension plan asset allocations by asset category are as follows:

| | Plan Assets December 31, 2007 | 2006 |
|---|---|---|
| **Asset Category** | | |
| Equity Securities | **66%** | 64% |
| Debt Securities | **33%** | 31% |
| Cash | **1%** | 5% |
| Total | **100%** | 100% |

The policy for the UES pension plan is to provide exposures to equity and debt securities by investing in a balanced fund. The fund will hold no more than 75% of its total assets in stocks.

**Estimated Future Benefit Payments**

The following benefit payments, which reflect future service, as appropriate, are expected to be paid by UES:

| | Pension Benefits | Other Postretirement Benefits |
|---|---|---|
| | - Thousands of Dollars - | |
| 2008 | $ 41 | $ 116 |
| 2009 | 66 | 117 |
| 2010 | 98 | 117 |
| 2011 | 152 | 115 |
| 2012 | 237 | 113 |
| Years 2013-2017 | 2,541 | 514 |

**DEFINED CONTRIBUTION PLANS**

UNS Electric offers a defined contribution savings plan to all eligible employees. The Internal Revenue Code identifies the plan as a qualified 401(k) plan. Participants direct the investment of contributions to certain funds in their account. UNS Electric matches part of a participant's contributions to the plan. UNS Electric made matching contributions of less than $0.5 million in each of 2007 and 2006

## NOTE 9. COMMON STOCK EQUITY

### DIVIDEND RESTRICTIONS

The ACC limits dividends payable by UNS Electric to UES and UniSource Energy to 75% of earnings until the ratio of common equity to total capitalization reaches 40%. UNS Electric met this ratio requirement at December 31, 2007 and at December 31, 2006. Additionally, the terms of the senior unsecured note agreements contain dividend restrictions. See Note 5.

### CAPITAL CONTRIBUTION

UniSource Energy made capital contributions to UNS Electric of $10 million in each of the years 2007 and 2006.

## NOTE 10. SUPPLEMENTAL CASH FLOW INFORMATION

A reconciliation of net income to net cash flows from operating activities follows:

| | Years Ended December 31, | |
|---|---|---|
| | **2007** | **2006** |
| | -Thousands of Dollars- | |
| **Net Income** | $ 4,754 | $ 5,105 |
| **Adjustments to Reconcile Net Income to Net Cash Flows** | | |
| Depreciation and Amortization Expense | 13,021 | 11,210 |
| Depreciation Recorded to Other O&M Expense | 447 | 357 |
| Amortization of Deferred Debt-Related Costs Included in Interest Expense | 219 | 251 |
| Provision for Bad Debts | 763 | 495 |
| Deferred Income Taxes | 152 | (2,761) |
| Pension and Postretirement Expense | 681 | 611 |
| Pension and Postretirement Funding | (761) | (624) |
| Changes in Assets and Liabilities which Provided (Used) Cash Exclusive of Changes Shown Separately | | |
| Accounts Receivable | (877) | (3,072) |
| Materials and Supplies Inventory | 160 | (1,936) |
| Income Tax Receivable/Payable | (592) | (1,667) |
| Accounts Payable | (603) | (1,527) |
| Interest Accrued | 120 | (50) |
| Taxes Accrued | 50 | 158 |
| Over Recovered Purchased Power Costs | 2,915 | 2,094 |
| Other | 1,358 | 5,128 |
| **Net Cash Flows – Operating Activities** | $21,807 | $13,772 |